NCSHA

May 6, 2019

Ms. Nicole Cimino	Ms. Jian Grant
Branch Chief	Senior Technician Reviewer
Office of Chief Counsel	Office of Chief Counsel
Internal Revenue Service	Internal Revenue Service
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Washington, DC 20224	Washington, DC 20224

Dear Ms. Cimino and Ms. Grant:

As the professional trade association of the agencies that administer the Low Income Housing Tax Credit (Housing Credit) in all 50 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands, the National Council of State Housing Agencies (NCSHA)[1] urges the Internal Revenue Service (IRS) to rescind the recently released final amended compliance monitoring regulations, and work with the states to develop a workable alternative.

The new regulation – 26 CFR part 1, Section 1.42-5(c)(iii)(B) – would impose an immense new regulatory burden on state Housing Credit agencies by significantly increasing the unit sample sizes states must monitor for compliance. We believe that any benefit the increase in monitoring would provide is far outweighed by the considerable strain this would put on Housing Credit agencies, owners, tenants, and affordable housing resources.

Most agencies would incur significant cost to comply with the provision, diverting resources that would otherwise more efficiently and effectively support affordable housing. The most vulnerable communities and properties would suffer the most. We do not see a justification for such a radical departure from the previous practice. We are unaware of any uptick in Housing Credit noncompliance that would support these changes in the compliance monitoring regime.

In addition to the increase in monitoring burden, NCSHA has grave concerns about the new requirement to conduct a random sample of tenant file reviews, as opposed to a risk-based approach to sample selection. NCSHA also believes that reduced time for the reasonable notice for owner notification is not feasible in practice.

NCSHA for decades has worked with the Service to ensure sound state administration of the Housing Credit. We respect the professionalism and expertise of the many IRS staff we have

[1] NCSHA is a nonprofit, nonpartisan organization. None of NCSHA's activities related to federal legislation or regulation are funded by organizations that are prohibited by law from engaging in lobbying or related activities.

worked with and appreciate IRS' consistent, responsive engagement over the years. Given this long, productive working relationship, we were surprised to see these substantial changes appear in final regulations, without consultation with NCSHA or our members. We hope that, once the Service fully understands the far-reaching negative consequences of the new regulations, it will work with us to make necessary revisions.

Summary of the Sample Size Provision

The new compliance monitoring final regulations replace temporary regulations (Rev. Proc 2016-15) that had been in place since 2016. Rev. Proc 2016-15 required states to conduct physical inspections and low-income certification reviews for the lesser of 20 percent of the units in a project or the number of units provided in the "Low-Income Housing Credit Minimum Unit Sample Size Reference Chart (Reference Chart)" set forth in the regulations.

Prior to Rev. Proc. 2016-15, IRS required states to monitor 20 percent of the units in all projects; however, this meant that states were monitoring an unnecessarily large number of units in larger properties. Thus, IRS introduced the Reference Chart in Rev. Proc 2016-15, which effectively provided monitoring relief for larger properties, while smaller properties were still subject to the 20 percent threshold.

The new final rule eliminates the 20 percent threshold entirely and requires all properties to be monitored according to the sample requirements in the Reference Chart. For properties with between 1 and 5 units, states must now monitor 100 percent of the units, 80 percent of the units in a 10-unit property, 60 percent of the units in a 20-unit property, and 50 percent of the units in a 30-unit property.

Impact of the Sample Size Provision

The relief provided to states for larger properties by the reliance on the Reference Chart is far eclipsed by the added burden of monitoring all or nearly all units in smaller properties now that the 20 percent threshold has been eliminated. According to HUD's Placed in Service (PIS) database, the median size of a Housing Credit property across the country is just 44 units. Thus, removing the 20 percent threshold means that in the median size property the number of units that the state must inspect went from nine to 17 with the implementation of the new regulations.

In many states, the vast majority of Housing Credit developments are small properties. In 39 states, more than half of the Housing Credit properties have 50 or fewer units. Moreover, in 15 states, more than half of the Housing Credit properties have 30 or fewer units.

However, as we explain below, Housing Credit compliance monitoring samples are not necessarily determined by the size of the property as a whole, but rather in accordance with the owner's election on line 8b of Form 8609 Part II. As such, individual buildings within a development may be considered separate projects. Thus, the average size of a project for purposes of compliance monitoring is in effect often much smaller than what the PIS database would suggest.

Large Increases in Units Subject to Site Visits

States have reported to NCSHA that the new rules will increase the number of units they must monitor by a significant amount.

The following examples provide an idea of the range in increased monitoring burden. Wisconsin reports an increase of more than 150 percent. Ohio reports that the new standard would require it to monitor between 90 and 100 percent of the units in one-third of its portfolio. In Indiana, the state agency would need to inspect 1,064 units more in 2019 than they would under Rev. Proc. 2016-15 if they implemented the new requirements that year. Even New York, which has more large properties in its urban areas, reports a 29 percent increase in the number of units they will need to monitor

Increased Costs to Hire Additional Staff

States from all over the country anticipate that they will be forced to hire additional compliance monitoring staff or significantly increase their payments to monitoring contractors to cover the additional monitoring requirements.

Texas reports that it would have to increase its current compliance monitoring staff of 18 by 11 additional full-time employees. Other states that have already told NCSHA they will need to hire additional staff include Alabama, Arizona, Delaware, Iowa, Montana, New York, North Carolina, Oregon, Utah, and Wyoming. Still other states have told us that adding additional staff is not an option for them due to budgetary constraints.

Not only does the new rule require more resources for staff and contractor costs, but it will also lengthen the amount of time compliance monitors must stay at properties, as a formerly one-day visit must now be a two- or three-day visit, adding to hotel and car rental costs, not to mention reduced time in the office.

Negative Ripple Effects on Properties and Other Housing Assistance

Added costs to meet the new mandate will require states to raise compliance monitoring fees. This will create hardships for property owners who may not have expected an increase in their operating costs, and may pass the increase on to tenants if the property's rents are below the maximum allowable.

Note that many states do not have the ability to increase compliance monitoring fees on existing properties, as they charge those fees up front, rather than on an annual basis. These states will likely be forced to redirect other agency resources, which would otherwise be used to further NCSHA members' affordable housing missions.

Other states have said that the increase in the sample size will require them to focus staff resources to monitoring properties during the initial 15-year Credit period, and they will be forced to reduce compliance monitoring of properties in the extended use period. This would be disastrous for our efforts to ensure affordability for 30 years or more.

Rural States Hit Hardest

The final rule hits rural areas the hardest, where properties are typically smaller and may be spread further apart geographically. In Kentucky 93 percent of the Housing Credit properties have 80 or fewer units. North Dakota reports that the new rule will double its compliance burden, as approximately 90 percent of its properties have fewer than 50 units.

The REAC Sample Requirements should not be Uniformly Applied to the Housing Credit

The sample size requirements in the Reference Chart are derived from sample sizes used in the Real Estate Assessment Center (REAC) protocol, which is used for physical inspections of Section 8 and other HUD properties. However, there are significant differences between the REAC protocol and inspection requirements under the Housing Credit. These differences make the REAC sample sizes far more onerous when applied to the Housing Credit program

REAC is a Physical Inspection Protocol Only

REAC inspectors perform physical inspections of properties, but do not perform the low-income certification reviews which are part and parcel of Housing Credit compliance monitoring. IRS regulations require state agencies to conduct an equal number of low-income certification reviews and physical inspections of units.

Tenant file reviews for low-income certification of households in properties that undergo REAC physical inspections are conducted by entities such as Performance-Based Contract Administrators (PBCA) as part of the Management and Occupancy Review (MOR) for each project. The Annual Contributions Contracts between HUD and PBCAs dictates the number of tenant files PBCAs must review. That number is far less than what state Housing Credit agencies must review under the new rule.

Example: a 50-unit development with one building

	No. Physical Inspections	No. Low-Income Certs.
REAC	18	5
Housing Credit	18	18

Multiple Building Developments are Always Treated as a Single Project Under REAC

NCSHA has consistently urged IRS to allow states to treat multiple buildings with a common owner and plan of financing as a single project for purposes of compliance monitoring, regardless of the owner's 8b election on Form 8609 Part II. Unfortunately, the Service has not adopted this recommendation. The 8b election issue has even more significance now that IRS has adopted the REAC sample sizes.

Unlike the Housing Credit, the number of units a REAC inspector must inspect is based on the number of units under HUD contract in the development, regardless of how many buildings it includes. However, IRS's regulations require state Housing Credit agencies to monitor according to the owner's 8b election. Thus, if the owner elects to treat each building in a property as a separate project, the Housing Credit agency must inspect far more units in the development than would be the case under the REAC protocol.

Example: a 50-unit development with five 10-unit buildings designated as separate projects

	No. Physical Inspections	No. Low-Income Certs.
REAC	18	5
Housing Credit	40	40

Housing Credit Physical Inspections Require More Follow-up than REAC

Compliance monitoring of a Housing Credit property is far more comprehensive than the actual onsite visit to the property. Following the physical inspection of a property, the state agency follows up on every single compliance violation, no matter how insignificant, to make sure the owner corrects it. Owners must provide states with work orders or invoices to prove that violations have been corrected, and if the state does not receive these, they continue to contact the owner until they do. Thus, increasing the number of units Housing Credit agencies must monitor not only increases the time it takes to conduct these inspections onsite, but also the time the agency must spend after the fact to ensure minor violations are corrected.

Conversely, the only follow-up required under REAC is if a property scores below a certain level or if the violation is considered an exigent health and safety concern. REAC requires no follow-up for violations such as broken screens or peeling paint. Therefore, the estimates of how time-consuming inspections are under REAC are not applicable to the Housing Credit.

The Public-Private Design of the Housing Credit Incentivizes Compliance

When Congress designed the Housing Credit, it put in place strong incentives for private owners and investors to maintain compliance with program rules, including ensuring the physical upkeep of properties. Investors in properties that are not well-maintained risk severe penalties, including the loss of future tax credits or recapture of previously claimed credits. For this reason, state agencies do not typically see severe noncompliance, and owners are typically quick to fix problems that the states do identify.

Owners of HUD properties that have never received a syndication of Credits do not have similar incentives, as Section 8 does not have the same sort of penalties in place in the program's structure.

15 Days Advance Notice to Owners is Insufficient

We also urge IRS to reconsider the reduction in the reasonable notice period that agencies must give owners before an upcoming physical inspection or review of low-income certification, which went from 30 days to 15 days in the final rule. We do not believe this provides state Housing Credit agencies, owners, or managers sufficient time to prepare for an inspection.

In many instances, state agencies require owners to provide certain documents—such as the affirmative marketing plan, tenant selection criteria, or evidence of service provision—in advance of inspections. Fifteen days may not give the owner enough time to get the state those documents or the state enough time to do that preliminary review prior to an on-site inspection.

Moreover, not only do state agency compliance staff travel to properties to do the inspection, but the owner must also sometimes send staff who do not typically work on site to the property to meet with the state. Nevada and Alabama both tell us that many of the owners of properties in those states have regional personnel that must travel from out of state to participate in the reviews. Alaska reports that many of the properties it monitors are accessible only by air, and travel is often impacted by weather. Air transportation not purchased well in advance can cost a premium, thus this will increase the travel cost for owners that may need to fly in staff for the inspection.

The 15-day requirement may translate in practice to even less time. Texas, for example, tries to visit several proximate properties in the same week, given the large geographic size of the state; and the agency issues the notice for all of those properties at the same time. That means that, while the last property they visit may get 15 days, other properties would get 14 days or 13 days, and so on. North Carolina has raised concerns that the shortened notice period may translate into even shorter notice given to tenants, whose units will be visited.

Furthermore, the new regulations prohibit states from providing owners with a list of the units they will monitor—either for low-income certification reviews or physical inspections—in advance of the actual inspection. However, in the case of low-income certification reviews, tenant files are not necessarily electronic and are often not kept onsite. Thus, this requirement necessitates owners bringing the tenant files for every unit with them to an inspection because they do not know in advance which tenant files they will need to pull. In the case of physical inspections, this does not provide sufficient notice to tenants, who would not find out that their unit had been selected until the day of the inspection.

A Risk-Based Approach to Low-Income Certification Review is More Effective than a Random Sample

The new regulations require state agencies to identify units for inspection using a random selection process. This applies to both physical inspections and low-income certification reviews. However, a random selection process is less effective for Housing Credit monitoring than a risk-based approach, which most agencies have been using under the temporary regulations.

Housing Credit regulations do not require annual income recertification of low-income tenants in 100 percent low-income buildings, as the statute allows existing tenants to remain eligible regardless of changes in their income after move-in. Thus, state agencies have typically chosen to conduct low-income certification reviews for households who have moved into the property since the prior inspection. Moreover, as low-income certification reviews are already required for compliance with Housing Credit units that are also financed with other federal subsidies, such as the HOME Investment Partnerships program funding or rental assistance, it makes more sense for Housing Credit agencies to focus their low-income certification reviews on households whose incomes are not otherwise reviewed for purposes of another program to maximize the number of households' files reviewed.

By adopting a random selection approach, it is likely that Housing Credit agencies would end up conducting low-income certification reviews for households that have been in the property for many years (and likely were already reviewed in previous compliance visits) and those who are already reviewed for purposes of another federal program.

Opportunity to Develop a Workable Alternative

We are unaware of any evidence that the Service's previous policy on site visit requirements for the Housing Credit Program and the states' implementation of it had failed to meet its purposes. Therefore, we urge the Service to rescind the new sample size provision in the final rule and return to the prior practice of monitoring the lesser of 20 percent of units or the applicable sample in the Reference Chart.

If IRS still feels that the compliance requirements under Rev. Proc. 2016-15 are insufficient, we urge it to consider alternative approaches that would reduce the burden on state agencies. Options the Service could consider include:

- Working with state agencies, through NCSHA, to develop an evidence-based process for determining the appropriate unit sample size(s) applicable to Housing Credit compliance, and relying on the expertise of state agencies in the determination of when additional units must be monitored;
- Basing compliance monitoring sample requirements on the total number of units in a property with a common owner and plan of financing, regardless of the owner's 8b election; and

- Allowing states to conduct fewer tenant file reviews than physical inspections.

These options are not mutually exclusive. We would urge IRS to consider them all, should it not rescind the new requirements outright.

State agencies understand that monitoring 20 percent of the units in a property is not always sufficient, and that the IRS's sample size monitoring requirements is a minimum threshold. In fact, states typically evaluate each property individually to determine if circumstances warrant monitoring of more units than the minimum IRS regulations have previously required. States may also decide to monitor a property more frequently than the once every three years requirement in the tax code. They make these determinations in accordance with the guidance provided in IRS's Guide for Completing Form 8823. State Housing Credit compliance monitors are in the best position to determine if a property needs to be watched more carefully, and a blanket one-size-fits-all approach in which many states are required to monitor every or nearly every unit in a great number of their properties—regardless of property history—is unnecessary, costly, and invasive for tenants.

Further, we strongly urge the IRS to allow states to determine which tenant files are reviewed according to a risk-based procedure rather than a random sample and to return to a 30-day owner notification requirement.

Thank you for considering our recommendations. We look forward to working with you to find a workable alternative to the new requirements.

Sincerely,

Garth Rieman
Director of Housing Advocacy and Strategic Initiatives

cc: Michael Novey, U.S. Department of the Treasury